SARASIN
& PARTNERS

Q1 2024
HOUSE REPORT

# TRUE GRIT

## The global economy proved remarkably resilient in 2023. Can it pull off the same trick in 2024?

- **Could anti-obesity drugs shift the balance of power in healthcare?**
- **Markets - not governments - are backing net zero**
- **Private equity Q&A: is the asset class still attractive?**

This document is intended for retail investors.
You should not act or rely on this document but should contact your professional adviser.

# INTRODUCTION

**STEPHEN ROTHWELL**
EDITOR

## Welcome to the first edition of the Sarasin House Report for 2024.

A year ago, the challenges facing investors looked formidable and many were bracing themselves for the worst. In the end, despite the succession of geopolitical shocks, the global economy held up remarkably well.

In his lead article, our Chief Market Strategist Guy Monson examines the factors contributing to this economic and market resilience, including improving inflation data and the phenomenal performance of the 'Magnificent 7' AI-related stocks. Looking into 2024, he sets out the investment outlook in a year in which improving financial conditions and changing market dynamics could present significant opportunities for thematic investors.

Looking out beyond this year, economists Subitha Subramaniam and Adam Hamilton argue that we are entering a new economic regime. Following consecutive years of unprecedented economic shocks such as the pandemic, rapid rate rises and recent geopolitical conflicts, markets are adjusting to a shift in economic forces, with implications for growth, inflation and ultimately, sources of returns for investors.

The US election is likely to be a keen focus for many investors this year. In our Geopolitical Pulse, Guy Monson and Henrietta Coldman review a number of key risks on the horizon, as well as their potential implications for portfolios.

While 2023 saw a handful of AI-related stocks dominate performance, our Chief Investment Officer for Equities, Jerry Thomas, sees scope for upside across a wider range of themes. One such theme that caught investors' eyes in recent months is the growing popularity of anti-obesity drugs. While initially mainly of interest to celebrities, the investment community has now firmly taken note. Alex Hunter looks at the potential for this market and how it may impact the broader healthcare sector.

Following the recent COP28 meeting, Head of Stewardship Natasha Landell-Mills demonstrates that while governments appear reluctant give meaningful support to the energy transition, the clean tech revolution is happening anyway. Green energy is becoming cheaper and more accessible, indicating it will likely continue taking market share from fossil fuels.

As we start a new year, many investors will no doubt be considering their portfolios' performance against their objectives. In our Charity Focus, Richard Maitland shares eight strategic tenets for investment success over the long term, including the importance of a steady evolution of ideas, strategies and asset classes, instead of a swift revolution.

Private equity garnered significant media attention during the course of last year and higher interest rates prompted questions about the market conditions for investors in private markets assets. We caught up with Alex Barr and James Witter, co-heads of Sarasin Bread Street, to understand the attractiveness of the asset class, where they see opportunities, and how investors can gain access.

We hope you enjoy these insights from our team. As ever, we welcome your feedback, so please get in touch with comments or suggestions at housereport@sarasin.co.uk.

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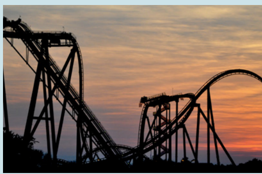

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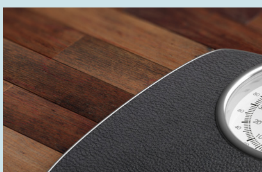

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**GUY MONSON**
CHIEF MARKET STRATEGIST
& SENIOR PARTNER

View from the
Chief Market Strategist

# TRUE GRIT

## The global economy proved remarkably resilient in 2023. Can it pull off the same trick in 2024?

> Momentum will now slow as interest rates bite, but the American economy looks set to achieve a rare thing – a soft economic landing.

**As we look back on 2023, the real surprise for investors was not the succession of geopolitical shocks, but rather the extraordinary resilience of the world economy. At the start of 2023 the challenges looked formidable, with war and an energy crisis in Europe, supply chains still disrupted by Covid and deteriorating China-US relations. Come October, investors faced the consequences of the Israel-Hamas war, which could yet widen into a regional conflict.**

But economic growth didn't stall. Indeed, the US actually saw a significant re-acceleration in third-quarter growth. Momentum will now slow as interest rates bite, but the American economy looks set to achieve a rare thing – a soft economic landing. Meanwhile, the UK and Europe will probably not escape recession, but any downturn will be mild.

## Disinflation is becoming the norm

The good news in 2023 was not confined to growth. Consistently weaker inflation data in the US and Europe fed a growing narrative that central bankers will ease monetary policy in 2024. Behind these disinflationary trends lies the healing of post-Covid supply chains, softer capital goods prices (especially from China) and steadily lower energy costs. Against this backdrop we now expect six US rate cuts in 2024, beginning in March, and a further four in 2025.

It is this near-Goldilocks scenario, including the real prospect of a soft landing, that fuelled investment gains in 2023. The rally was most evident among super-cap US technology stocks, the so-called 'Magnificent Seven'. These accounted for a staggering two-thirds of the rise in the S&P 500 last year, reflecting optimism about the break-neck pace of development and deployment of artificial intelligence (AI).

## We were too cautious

We were, in retrospect, too cautious – modestly underweighting equities and holding precautionary positions in cash for much of 2023. Against a background of relentlessly rising interest rates, we were particularly wary of equity valuations. And while we held a number of the 'Magnificent Seven' AI winners, we did not hold them in the quantities needed to match the technology component of the index.

As headline inflation started to fall over the summer and with a growing confidence that the peak in interest rates had likely passed, we started adding first to corporate bond exposure and then to equities. By the fourth quarter we also saw the beginning of a widening in equity market leadership, with global equities now rallying alongside US shares. Taken together, this proved to be a more supportive environment for our investment style and asset positioning.

Beyond equities, our bond holdings performed well and we added to credit and extended duration over the summer as UK corporate yields soared above 6%.[1] We also added modestly to our holdings of infrastructure and to renewables funds, where discounts to net asset value had fallen to levels last seen in the darkest days of the 2008-9 Great Financial Crisis. Both moves were well timed, as bond yields fell back sharply in the last quarter of 2023 and discounts started to narrow.

## Beware geopolitics

Looking ahead, the geopolitical risks today seem even more daunting than they did a year ago. Of greatest immediate concern is potential escalation in the Israel-Hamas war, which now reaches the Red Sea and Israel's border with Lebanon. So far, the absence of a wider regional conflict has allowed energy prices to fall, with none of the strategic reductions in supply (outside of regular OPEC+ meetings) that marked earlier Arab-Israeli conflicts. We believe this crisis can still be contained: there is little evidence that Iran wants to escalate the conflict or that the larger Arab states want to use oil to 'punish' the West. Human suffering on both sides remains intense and that must be policymakers' priority.

Meanwhile the stalemate in Ukraine looks set to remain, albeit with horrific attacks on civilian infrastructure. We believe that ways will be found to deliver the aid to Ukraine that is currently stalled in the US and EU. Any diplomatic route towards a settlement in 2024 would likely help market sentiment. Meanwhile, with Europe having largely severed its links to Russian energy, Russia's ability to put pressure on the West is greatly reduced.

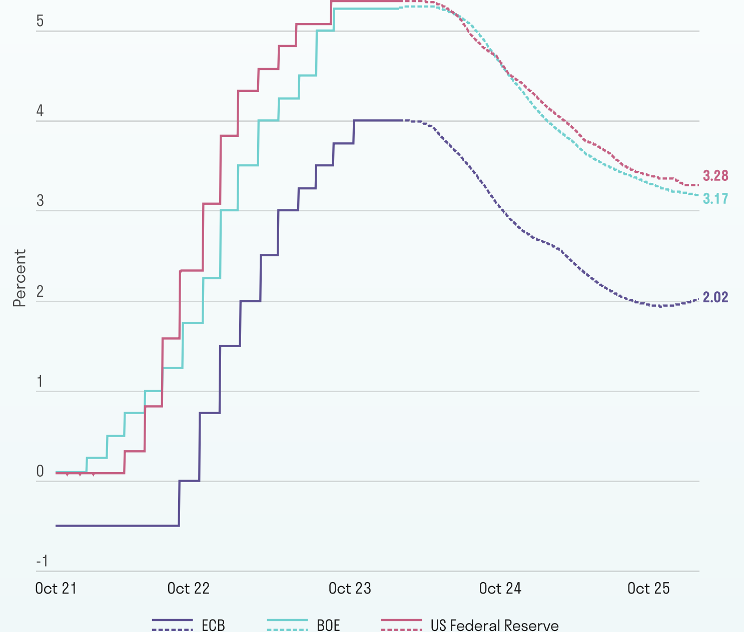
## Is there value in Chinese equities?

Talks between the presidents of the world's two largest economies took place in San Francisco last November, marking what could be the first steps towards thawing Sino-US relations. The wins were modest – high-level military communications were restored and fentanyl supplies restricted – but the dialogue alone was important.

From an investor's perspective, the question is whether talks are enough to stem the outflow of capital from Chinese markets in the face of an extraordinarily hostile and

**CHART 1** MARKETS SEE INTEREST RATES FALLING SHARPLY IN 2024

MARKET IMPLIED POLICY RATES

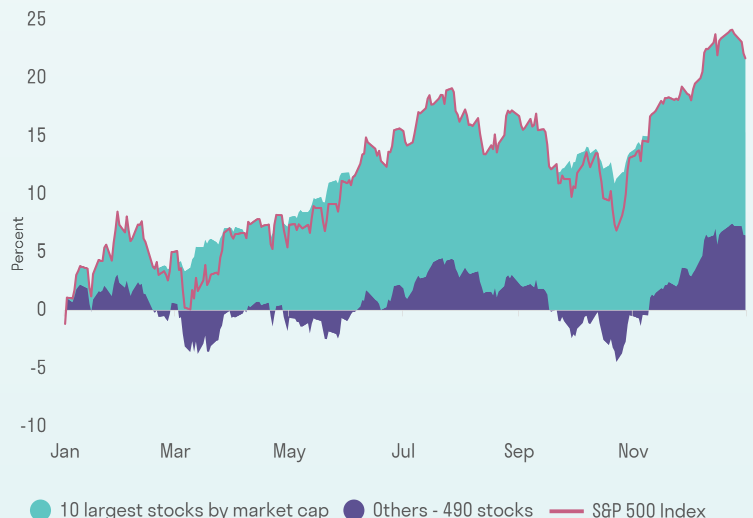



SOURCE: MACROBOND, JANUARY 2024

**FORECASTS ARE NOT A RELIABLE INDICATOR OF FUTURE PERFORMANCE AND MAY DIFFER TO ACTUAL PERFORMANCE ACHIEVED.**

**CHART 2** US MARKET LEADERSHIP IS FINALLY STARTING TO BROADEN

CONTRIBUTION TO PERFORMANCE OF S&P500




SOURCE: MACROBOND, JANUARY 2024

**PAST PERFORMANCE IS NOT A RELIABLE INDICATOR OF FUTURE RESULTS AND MAY NOT BE REPEATED.**

# TRUE GRIT

Guy Monson, Chief Market Strategist
& Senior Partner

bi-partisan US Congress. Chinese equity markets were the stand-out underperformers of 2023: while the S&P 500 is now 24% higher than it was three years ago, the MSCI China is 50% lower.[2]

Following our analysts' visits to China and Hong Kong last year, we remain defensive. Before committing funds to the region we would like to gauge China's reaction to Taiwan's national elections, which are due to be held on 13 January. We would also like to see evidence that residential property prices are starting to bottom, together with convincing moves by the Chinese government in support of foreign inward investment. Xi's outreach to US executives on his Californian visit was a step forward, but China's abrupt new regulations for gaming companies in late December were a step back.

## A super, super-election year

More than 70 countries will hold elections in 2024, with more than two billion voters heading to the polls, from the United States and Mexico to India and South Africa.[3] The UK may also see a general election, but with little to choose between Conservative and Labour economic policies, investment risk should be low.

The headline-grabber remains the November 2024 US elections, in which control of the House of Representatives, the Senate and the presidency could all change – a rare instance of Republicans and Democrats battling for all three levers of elected power in Washington.

Recent polls show Donald Trump consistently ahead of President Biden, despite ever-mounting legal challenges, but early presidential polls are notoriously unreliable. It is also worth remembering that Trump's last presidency was rewarding for equity investors. It saw the S&P 500 rise by more than 50% – a figure substantially above the average for presidencies since the 1980s.[4] The investment risks posed by the US election could be meaningful, particularly if Trump's universal tariffs are enacted, but it's probably too early to assess the impact on markets.

## A broadening of market leadership?

2023 was a difficult year for active investors. The lion's share of equity returns came from a handful of stocks, in what was probably the most extreme concentration of returns since the 1960s.

It was a particularly challenging year for our multi-thematic managers, who were essentially operating in a market focused on just one theme – AI. Other high-growth themes were largely ignored by the market, including robotics, climate transition, smart buildings, electrification and medical diagnostics. In short, real value is building up across our investment themes, such that if market returns do broaden, our clients' portfolios should be well positioned.

Where else might this widening of returns be felt? After a dull 2023, the opportunities in global equity income look promising, with global dividend growth now expected to be in excess of 8% in 2024, well ahead of inflation. Valuations too are attractive with the MSCI World High Dividend index offering a yield close to 4% and a forward price/earnings multiple of just 11.[5]

## Investment policy implications

The prospect of lower inflation and resilient economic growth were powerful drivers of investment markets in the final quarter of 2023. Our clients benefited from the upswing, which delivered strong absolute returns across portfolios.

Market leadership will likely broaden in 2024 - indeed we have already seen tentative signs of this over recent weeks. In turn, this should allow other investment themes offering long-term growth at reasonable valuations to shine as the year progresses. In particular, in a climate of falling interest rates later in the year, the opportunities for equity income mandates with strong dividend growth should also return.

Against this backdrop, our multi-thematic investment process, and our focus on long-term income growth, look well positioned for market conditions in the year ahead.

[1] All data in this article sourced from Macrobond, as at 3 January 2024, unless stated otherwise.

[2] Macrobond, 3 January 2023

[3] The Economist: 2024 is the biggest election year in history, 13 November 2023

[4] Reuters, December 2023

[5] FactSet, 3 January 2024

Economist's Outlook

# OUT WITH THE OLD, IN WITH THE NEW

**SUBITHA SUBRAMANIAM**
CHIEF ECONOMIST

**ADAM HAMILTON**
ECONOMIST

**It's been a roller coaster ride for investors. A steady stream of unprecedented shocks has buffeted economies and markets: the pandemic; Russia's invasion of Ukraine; and now an Israel-Hamas conflict that threatens to engulf the wider Middle East region. All the while, a cold war between the US and China and extreme weather events have been gaining force.**

These shocks and the accompanying volatility are a far cry from the low inflation and low interest rates that followed the Great Financial Crisis of 2008-'09 (GFC). They reflect a meaningful shift in the drivers of market behaviour – typically called a market regime.

> We are entering a new market regime in which old certainties no longer apply. Understanding the new prevailing forces is essential to planning a long-term investment strategy.

## What is a market regime?

Key investment inputs such as inflation, growth and volatility can trend higher or lower for decades at a time. These persistent trends mean that using long-term historical averages as a predictor of value or guide to future returns might be less useful.

For example, the floating of currencies in the 1970s and the unofficial adoption of inflation targeting by central banks in the 1990s contributed to more stable inflation and higher asset prices. Incorporating this regime shift into investment decisions would have substantially benefited investors. However, regime shifts can sometimes be masked by the volatility of the business cycle, so it is vital to distinguish between the two when planning a long-term investment strategy.

## Demographics are changing how we save, spend and invest

The demographic dividend that advanced economies enjoyed from 1970 to 2010 is starting to reverse. Following World War II, birth rates surged and female participation in the labour force increased dramatically. Around 2015, this demographic windfall began to reverse as populations began to age. The ongoing shift towards older demographics is recalibrating the balance between savings and investments, moving from a world of net savers to net consumers. Ageing populations may also dampen productivity growth as more economic resources are diverted to lower-productivity care sectors. The coming demographic reversal is expected to raise global interest rates.

# OUT WITH THE OLD, IN WITH THE NEW

Subitha Subramaniam, Chief Economist & Adam Hamilton, Economist

## Technology – AI will boost productivity

The digitalisation of the global economy has been a key driver of productivity. Breakthroughs in generative artificial intelligence (AI) could significantly increase productivity and temper inflation pressures. Over the next decade the technology sector could add meaningfully to productivity growth. Investment strategies should include enablers and beneficiaries of AI and automation.

## Government debt could come with a hangover

Over the next decade, fiscal deficits in advanced economies are expected to reach levels rarely seen outside of wartime or recession. In the US, persistent deficits are expected to raise already-high debt levels by around 10 percentage points by 2035. Such fiscal largesse, while stimulating demand in the short run, could reduce long-run growth by 0.2 percentage points annually while raising long-term interest rates by 0.15-0.45%.[1,2]

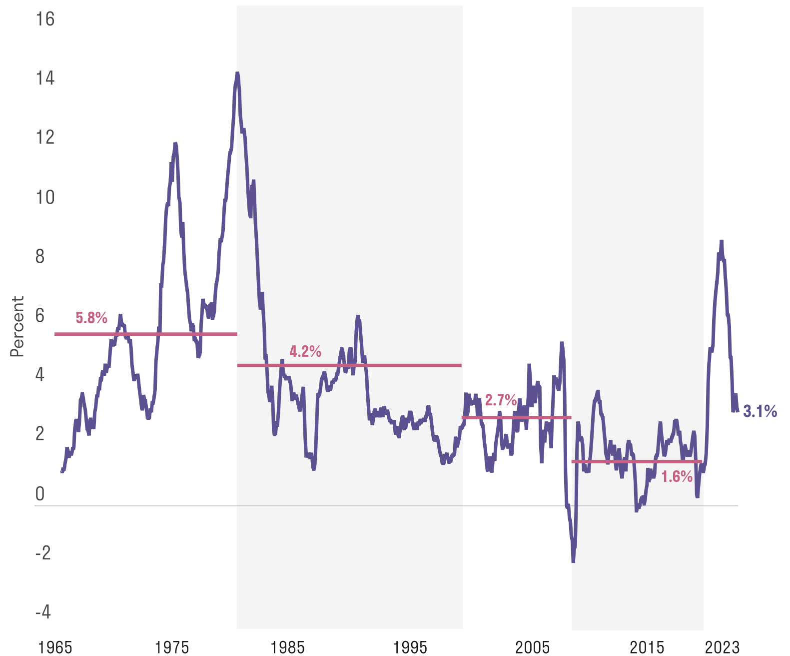
Larger deficits are putting upward pressure on short-term interest rates as central banks seek to counteract the inflationary impact of fiscal stimulus. Long-term interest rates have risen, reflecting higher short-term interest rates and higher risk premia. As a result, other productive investment opportunities will suffer.

Unfortunately, the composition of this increased government spending is unlikely to contribute to productivity growth over the next 5-10 years. Defence spending and subsidies for investing in onshoring and renewable energy effectively replace or duplicate the existing capital stock rather than adding to it.

## Green transition = investment opportunity

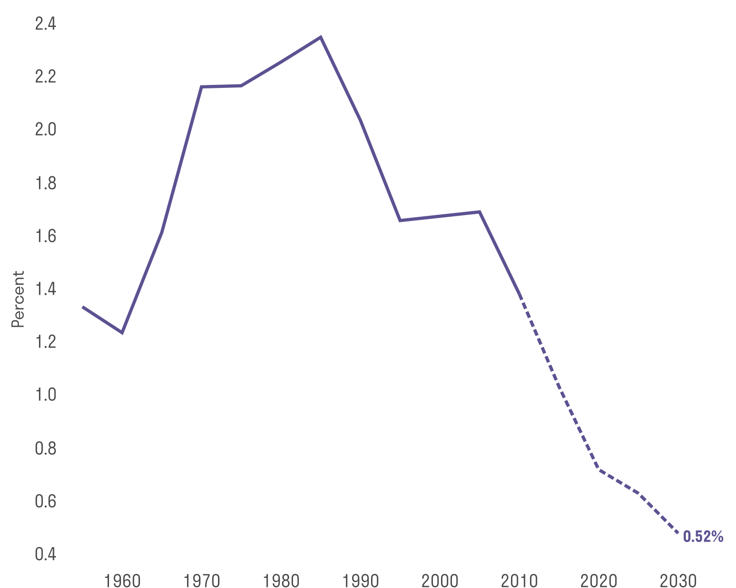
The shift towards a greener economy is gaining momentum, fuelled by regulatory measures and substantial investment. Following the introduction of the Inflation Reduction Act in the US, over $100 billion of clean energy manufacturing investments have been announced.[3] The latest Intergovernmental Panel on Climate Change report suggests spending globally on the transition needs to increase by between $1-$4 trillion per annum.[4]

**CHART 1** US HEADLINE CPI ACROSS DIFFERENT REGIMES




SOURCE: MACROBOND, JANUARY 2024
**PAST PERFORMANCE IS NOT A RELIABLE INDICATOR OF FUTURE RESULTS AND MAY NOT BE REPEATED.**

**CHART 2** WORKING AGE POPULATION, 15-64 (MORE + LESS - LEAST), % CHANGE




SOURCE: MACROBOND, JANUARY 2024
**PAST PERFORMANCE IS NOT A RELIABLE INDICATOR OF FUTURE RESULTS AND MAY NOT BE REPEATED.**

**TABLE 1** ECONOMIC OUTLOOK UNDER A CHANGING REGIME

| | | |
|---|---|---|
| **Real GDP growth** | 2.0% | Modestly weaker growth due to demographic shifts and stable productivity growth. |
| **Inflation** | 2.25% | Upward pressure from demographics, loose fiscal policy, unproductive investment and trade barriers. |
| **Real interest rate (r*)** | 1.25% | Sum of real GDP growth and the savings investment balance. |
| **Nominal interest rates** | 3.5% | Upward pressure from inflation, savings and investment are slightly offset by weaker growth. |
| **Fair value 10-year bond yield** | 4.0% | Sum of short-term interest rates and term premium. |

SOURCE: SARASIN & PARTNERS, JANUARY 2024

This green transition will increase inflationary pressure as prices shift to incentivise reallocation of resources. Productivity is also likely to suffer as investment spending is diverted and existing capital stock becomes obsolete.

## A divided world is inflationary

Escalating geopolitical tensions and trade fragmentation are also expected to raise inflation modestly and drag on economic growth. Trade barriers, which initially appear as mere speed bumps, are likely to partially reverse the deflationary effects of integrating China and former Soviet states into the global economy over the past 30 years. Estimates from the IMF suggest that trade barriers could slowly erode annual productivity and economic growth by 0.2 percentage points over 10 years, even as countries successfully circumvent them.[5]

Increasingly fragmented trade and finance may be associated with reduced demand for US dollars and assets. Savings from emerging market economies contributed to the savings glut that put downward pressure on interest rates in advanced economies over the past 20 years. Again, this could potentially contribute to a firming in global interest rates going forward.

## The new economic outlook

As markets adjust to the shift in economic forces, we are beginning to see the rough contours of the new regime. The table above is an illustrative example of how key variables in the US are likely to trend over the next 5-10 years in this regime. These estimates are not precise forecasts, but rough guides to the direction of travel.

Overall, growth will be modestly weaker due to demographic shifts and stable productivity growth. AI presents a wildcard with large potential upside.

Inflation is likely to break from the low levels that characterised the post-GFC era. Central banks are expected to respond with higher interest rates to manage inflationary pressures, marking a departure from the prolonged savings glut era. As a result, US interest rates could average around 3.5% over the next decade – about 1 percentage point higher than in the previous regime.[6]

Central banks are also likely to be less keen on policies like quantitative easing. After recording large losses on previous purchases, they may be less willing to risk taxpayers' money. Central banks have been price-insensitive buyers of assets and have seemingly underwritten indiscriminate risk taking. Without their support investors should expect greater volatility of asset prices, higher dispersion of returns within asset classes and lower valuations overall. In particular, the bond term premium (the extra yield that investors demand for holding longer-term bonds) is likely to rise from 0% to 0.5% over the next 5-10 years.[7] This should be a fruitful environment for active, well-researched investment strategies.

## Higher volatility brings greater opportunities

Investors' returns will continue to be driven by bearing risk – with equities remaining a main engine of returns. However, with other asset classes such as bonds now offering respectable long-term returns, a more traditional approach to asset allocation is likely to be warranted. Greater expected volatility will significantly increase the benefits of diversification, particularly for multi-asset approaches focused on harvesting risk premia across different asset classes.

Finally, as the world adjusts to the new regime there will be greater dispersion between the winners and losers: it will be more important than ever to identify the shifts in global trends and long-term investment themes.

[1] Source: Sarasin & Partners analysis and The Cato Journal, The Impact of Public Debt on Economic Growth, 2021.

[2] Source: The Aggregate Demand for Treasury Debt, Krishnamurthy and Vissing-Jorgensen, 2007 (working paper)

[3] Source: Climate Action Tracker

[4] Source: IPCC (Intergovernmental Panel on Climate Change), AR6 Synthesis Report: Climate Change 2023

[5] Source: Geoeconomic Fragmentation and the Future of Multilateralism by IMF 2023

[6] Sarasin & Partners, January 2024

[7] Sarasin & Partners, January 2024

**HENRIETTA COLDMAN**
INVESTMENT MANAGER

**GUY MONSON**
CHIEF MARKET STRATEGIST & SENIOR PARTNER

# Geopolitical Pulse
# A YEAR OF ELECTIONS

**More than 70 countries will hold nationwide elections in 2024. Most ballots will be cast in Asia and many elections will likely result in the entrenchment of populist leaders.[1]**

For investors, the most impactful will be the 2024 presidential election in the US, where a second Trump presidency is now a real possibility. This has implications for portfolio holdings if US tariffs are increased, climate commitments reversed or US foreign aid withdrawn.

We will be keeping a watchful eye on stateside political developments, which will likely include increased market volatility as we head towards November 2024.

## Our methodology

**Geopolitical Pulse is based on a risk-monitoring approach developed by Sarasin & Partners. We have found it to be a useful tool when thinking about multi-faceted and variable risks that affect our tactical portfolio positioning.**

Our risk analysis of global political developments is updated quarterly, and used to inform the asset allocation decisions taken at our Investment Policy Committee meetings.

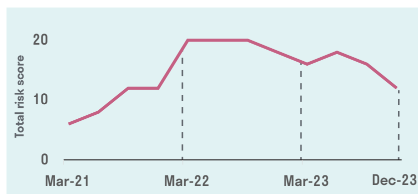
The qualitative method is simple but practical, with each risk – assessed in terms of its potential impact – is assigned a score (1-5), a probability (1-5) and a total risk score (1-25 = risk x probability).

## 1 UKRAINE CONFLICT

**Decreased** – Enhanced European energy security and likely stalemate.

- Ukraine's offensive has stalled and Russia has stockpiled missiles in a bid to break Ukraine's energy grid this winter.
- A stalemate is likely to favour Russia, which has managed to garner foreign support and has moved its economy to a war footing.
- Meanwhile, Congress appears reluctant to release funds for Ukraine and Hungary has blocked EU aid.
- With a Trump presidency looking increasingly likely, a 'weak Ukraine' deal seems plausible.

**Total risk score: 12/25**




As at 14 December 2023, Sarasin & Partners

### PORTFOLIO IMPLICATIONS

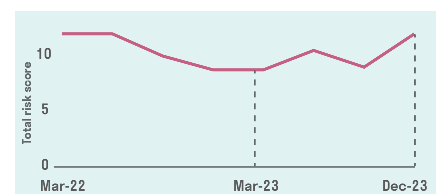
- Continued price volatility likely in grain, foods and fertiliser.
- The need for energy security could boost investment in renewables.
- Cyber defence is a key sub-theme for portfolios.
- Defence stocks have a role in global portfolios.

## 2 ISRAEL-HAMAS & OTHER MILITARY RISKS

**Increased** – Inception of Israel-Hamas conflict and North Korea/Iran alliance with Putin deepens.

- The Israel-Hamas conflict has not yet triggered a wider regional crisis.
- North Korea launched its first spy satellite in November, and aims to create a nuclear arsenal to shift the balance of power in north Asia.
- Multi-nationals are adding clauses relating to China-Taiwan tensions into commercial contracts. The election of pro-unification KMT in Taiwan could reduce tension with China.
- NATO launches biggest joint exercise since the Cold War.

**Total risk score: 12/25**



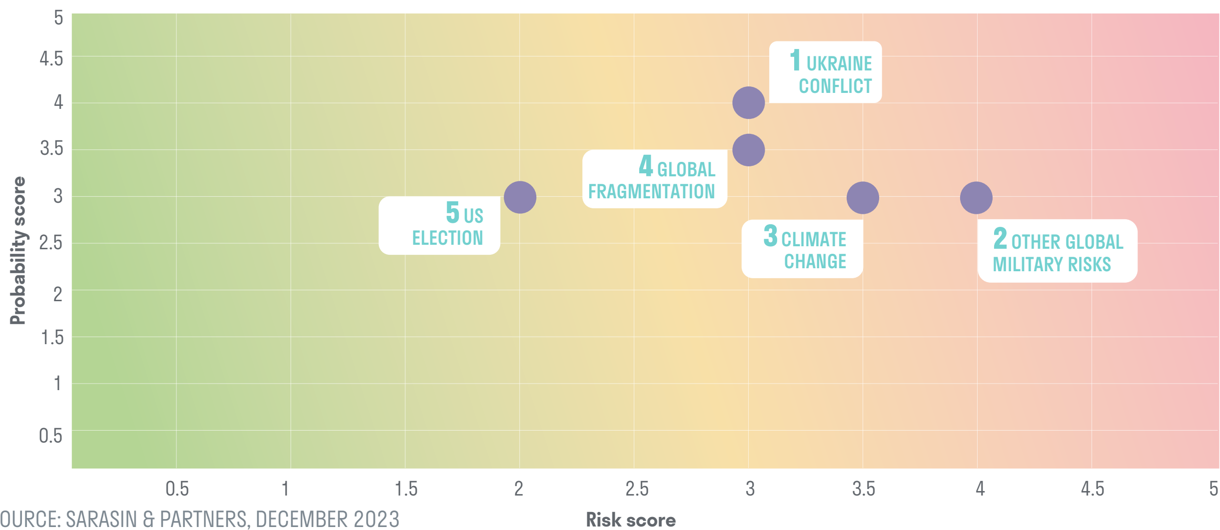

As at 14 December 2023, Sarasin & Partners

### PORTFOLIO IMPLICATIONS

- Financial markets are largely absent from these geographies.
- Prolonged Israel-Hamas conflict could see reduced Arab oil exports and higher energy prices.
- Defence stocks have a role in global portfolios.
- Technology is a key battlefront between the US and China.
- Long-term risk to TSMC (Taiwan) merits diversified semiconductor exposure.

[1] The Economist: 2024 is the biggest election year in history, 13 November 2023

GEOPOLITICAL PULSE SCORES



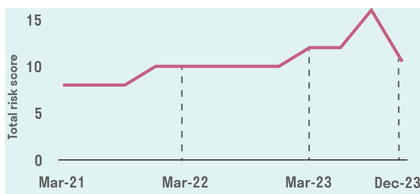

SOURCE: SARASIN & PARTNERS, DECEMBER 2023

## 3 CLIMATE CHANGE

**Unchanged** – Renewables growing but world climate agenda is off track.

- Oil and coal usage hit record highs in 2022. Global temperatures likely to breach 1.5⁰C in the next five years.
- Likely progress at COP28: pledges to triple alternatives generation by 2030 and double energy efficiency by 2030, and commitment to methane reduction.
- Drought in the Panama Canal exacerbated by El Niño is driving up shipping costs.
- Liquefied natural gas terminals in Europe could have surplus capacity by 2030 as renewables grow.
- Renewable capacity will meet 35% of global power generation by 2025 (IEA).

**Total risk score: 10.5/25**




As at 14 December 2023, Sarasin & Partners

### PORTFOLIO IMPLICATIONS

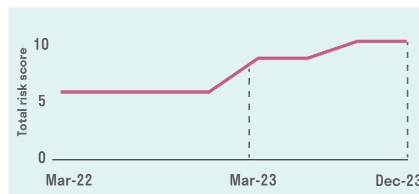
- Unprecedented investment needed to address climate change.
- Increased global infrastructure spend to counter extreme weather conditions.
- Climate transition opportunities offer unique re-rating potential for equities.
- Biden climate programme growing to over $1 trillion
- Electrification will create vast demand for metals.

## 4 GLOBAL FRAGMENTATION

**Unchanged** – Traditional western alliances remain fragile.

- Conflict in the Middle East has stretched American and European resources, while relieving pressure on Russia and prompting China to align itself with the Palestinian cause.
- Some success for China in internationalising its currency, but its Belt and Road Initiative (BRI) is stalling and African members are increasingly indebted.
- US & EU back India-Middle East transport corridor to rival BRI, while Vietnam and US upgrade relations to counter China.
- India's role in the global economy is growing.

**Total risk score: 10.5/25**




As at 14 December 2023, Sarasin & Partners

### PORTFOLIO IMPLICATIONS

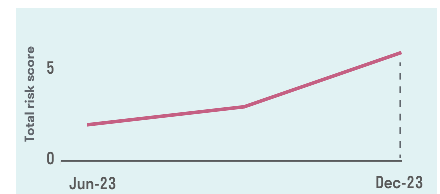
- De-globalisation may mean multi-year weakness for the US dollar and a higher gold price.
- China equity markets face permanent de-rating as US investment is curtailed.
- 'National Champions' such as big tech in the US are in favour.
- Emerging markets may pay less heed to developed nations in regard to energy and ESG.
- We are extending our coverage of Indian asset markets.

## 5 US ELECTION

**Increased** – It's an unpopularity contest between ageing candidates but a Trump presidency is now a real possibility.

- Risks include US tariffs, a controversial peace settlement in Ukraine and withdrawal / reversal from climate commitments.
- Trump's popularity is rising despite criminal charges, but he might be convicted before the election.
- Democrats have historically relied on black and Hispanic voters, but many are seemingly abandoning the party.
- However, most sitting presidents win re-election if there is no recession in the election year.
- Support for Nikki Hayley suggests Republican appetite for change.

**Total risk score: 6/25**




As at 14 December 2023, Sarasin & Partners

### PORTFOLIO IMPLICATIONS

- Equity volatility likely to rise as election approaches.
- A Trump victory could see de-rating in climate change stocks that benefit from Biden's Inflation Reduction Act funding.
- Pressure could grow to end the Ukraine conflict, with unclear implications for markets.
- Foreign policy differences between candidates suggest global asset allocation risk.

JEREMY THOMAS
CHIEF INVESTMENT OFFICER, GLOBAL EQUITIES

# INVESTMENT THEMES: MORE THAN MEETS THE AI

> After 2023's impressive market gains, we see scope for further upside across a wider range of equities

**Sometimes it seems that the equity market can hold on to only one idea at a time. In 2023 that idea was artificial intelligence (AI), but 2024 could see the markets widen their interests.**

Market returns in 2023 surprised even the most optimistic of expectations. The 'Magnificent Seven', the largest US-listed technology companies, rose 107% ($, total return) over the year.[1] In the process they added around $4.7 trillion to the value of the of the S&P 500 Index – equivalent to nearly twice the value of the entire FTSE100 index.

The spectacular returns from this handful of stocks was in part a comeback from their weakness in 2022. But it was largely thanks to excitement about the disruptive potential of generative artificial intelligence (AI).

## Gen AI

Released on 30 November 2022, ChatGPT took just two months to clock up 100 million users, a milestone that even the runaway success TikTok took a full nine months to achieve.[2]

We too are excited about the potential for this disruptive technology to create new software applications, automate tasks and deliver productivity gains across the economy. So far, AI has accelerated demand for advanced semiconductors, such as graphics processing units (GPUs), and will accelerate the adoption of cloud computing. In time, it will allow software companies and the owners of unique data sets to charge more for their products.

However, looking back over the past two decades the scale of US technology's gains in 2023 is rivalled only by the sector's performance in 2009 and 2020. In both these earlier instances, tech performance over the following years was less remarkable and more in line with the overall market. Although it is too soon to suggest that the 'Mag 7' could become the 'Lag 7', healthy equity markets do require a broader and more diverse range of winners.

Fortunately, our multi-thematic approach provides strong clues as to where these non-AI winners might be found.

## Demographic demands

According to the World Health Organization, the global population aged 60 years or older will double between 2015 and 2050.[3] This would see a decline in the working-age population and a rise in the

number of people dependent on healthcare systems and savings. Such an extraordinary step-change in ageing would bring major changes in consumer behaviour and could also turbo-charge investment in automation.

Productivity gains are essential if economic growth is to be generated without growth in the workforce. This will drive accelerating demand for factory automation, machine vision, precision agriculture, supply chain technology and testing. Portfolio companies that we expect to benefit from these profound social changes include Siemens (smart infrastructure), Deere (agriculture), Keyence (machine vision), Thermo Fisher (laboratory supplies) and Prologis (logistics real estate).

An ageing population also places greater demand on healthcare systems. A new class of anti-obesity drugs from Eli Lilly, Novo Nordisk and Amgen could contribute to healthier populations with longer lifespans, while also reducing healthcare costs for individuals and governments.

However, we believe that the potential for anti-obesity drugs to disrupt the medical technology industry is probably over-stated, particularly when longer-term growth in the patient population is taken into account. We see attractive investment opportunities among medical devices companies such as Smith & Nephew and Medtronic. These, we believe, have been unfairly marked down by the markets during the recent craze for anti-obesity drugs and currently offer considerable value.

## A changing climate

The National Oceanic and Atmospheric Administration and multiple other sources, expect 2023 to have been the hottest year on record.[4] This is the result of El Niño conditions and human-caused climate change. At the COP28 conference held in Dubai in December, countries agreed to push towards tripling renewable energy capacity, doubling the rate of energy efficiency improvement by 2030, and tripling nuclear capacity by 2050. This will require enormous private sector funding and deeper supply chains, while fuelling demand for key commodities and stimulating the development of new technologies.

> An ageing population also places greater demand on healthcare systems. A new class of anti-obesity drugs from Eli Lilly, Novo Nordisk and Amgen could contribute to healthier populations with longer lifespans.

We see great long-term opportunities in companies that can assist in the transition to lower-carbon economies and adjusting to climate change. These include Dassault Systèmes (software) and Tetra Tech (consultancy), select commodity stocks such as Lynas Rare Earths, Air Liquide (hydrogen technology) and Daikin, a specialist in heat pumps and air conditioning.

Ultimately, there is an urgent need to reduce real-world emissions in hard-to-abate sectors. To help make this a reality, we continue to engage with companies, pressing them to commit to more stringent science-based carbon-reduction targets and urging them to invest in climate adaptation and mitigation.

## Broadening out

After 2023's impressive market gains, we see scope for further upside across a wider range of equities, provided that inflation continues to fall and lower interest rates support higher valuations in the parts of the market that lagged last year.

This broadening out will benefit companies across our Ageing, Automation and Climate Change themes, as they take up the baton from Digitalisation, which led the way so magnificently in 2023.

[1] All data in this article sourced from Bloomberg/S&P as at 3 January 2024, unless stated otherwise

[2] Reuters, 2 February 2023

[3] World Health Organization, Ageing and health, 1 October 2022

[4] National Oceanic and Atmospheric Administration, December 2023

ALEX HUNTER
PARTNER

# ANTI-OBESITY DRUGS: WEIGHING THE POTENTIAL

> It's been a phenomenal year for producers of anti-obesity drugs. Could these drugs really shift the balance of power in healthcare and change consumer habits?

**'Diabesity' drugs have dominated headlines in recent months. The first of these was launched to little fanfare in the midst of the Covid pandemic in 2021, but as early adopters – often celebrities – showcased the seemingly miraculous results from these drugs, the world sat up and took notice.**

The scientific community came on board in summer 2023 after results from the first rigorous, large-scale trial (Novo Nordisk's*[1] SELECT trial[2]) confirmed the weight-loss effects of glucagon-like peptides (GLPs) – with far-reaching ramifications.

Bearing the brunt are healthcare companies focused on conditions associated with being overweight or obese – principally diabetes and heart conditions. Also in the firing line were companies linked to joint replacements, dialysis, sleep apnoea relief, weight management products, food retailing, alcohol, fast food, snacking, casual dining and even coffee.[3] Sarasin's thematic global equity portfolios have little exposure to consumer services that could be most affected, such as fast food and casual dining.

In our view, the market down-draught caused by GLPs has created good buying opportunities among healthcare companies that have been marked down unfairly. However, we also think that the potential market for GLP drugs may have been greatly under-estimated.

## The skinny on GLPs

After many years of work and numerous dead ends, two pharmaceutical giants – Eli Lilly* (held under our Ageing themes) and Novo Nordisk – can now offer two GLP medicines for weight loss and the treatment of associated co-morbidities, such as diabetes and heart disease.

Glucagon-like peptides (GLPs) are hormones, signalling molecules that the body uses to control blood sugar levels. They are part of the endocrine signalling system, which regulates the central nervous system and can suppress appetite.

The ability of GLPs to affect bodyweight and blood sugar levels was first confirmed in the 1980s, but it took many years to make them suitable for injection. GLPs have been in commercial use in treating diabetes since 2005, providing researchers with a long track record of their effects.

Unlike most weight-loss treatments, GLP drugs act on the body's own regulation system to reduce appetite, essentially signalling to the brain that the person is 'full'. They are intended to be used in conjunction with lifestyle changes, usually increased exercise and improved diet, without which treatment is less likely to lead to longer-term health benefits. GLPs are not without side effects, which include nausea, gastrointestinal issues and loss of muscle mass.

As well as having the potential to reduce the incidence of heart disease and diabetes, GLPs could be beneficial in the treatment of chronic kidney disease, hypertension, some cancers and osteoarthritis. This would not only be extremely beneficial for society – it could also significantly reduce healthcare costs for individuals, governments and insurance companies.

## How big could the GLP market get?

Demand for these drugs has surprised even long-term watchers of the pharmaceuticals sector. Just six months after the launch of Wegovy (a higher-dose version of Novo Nordisk's GLP drug Ozempic), 1% of the Danish population were taking it, according to the CEO of Novo Nordisk.[4]

So far, the focus has been on how GLPs might be used to treat obesity-related conditions, their long-term safety record, and also the drugs' reception among US insurance companies and physicians. The US healthcare market is the largest in the world: what happens there can determine the success or failure of new drugs. To date, most US insurers will only pay for GLP use for weight-related conditions – not for weight loss alone.

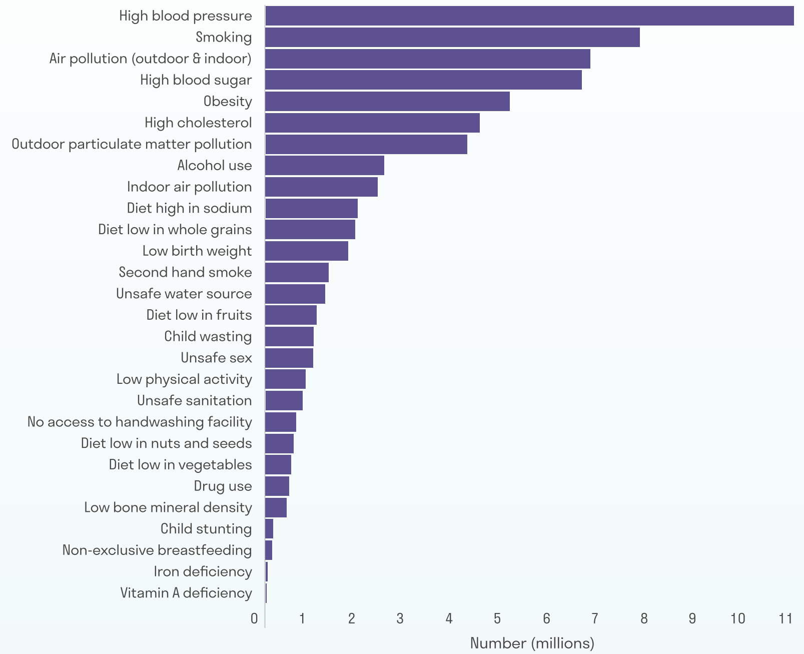
Seen through this lens, we believe that the global market for GLPs as prescription-only drugs is likely to reach $75 billion by 2027 and perhaps $100 billion by 2030. This estimate, however, does not fully take account of potential new indications, such as liver and Alzheimer's disease, as well as the potentially even higher use of GLPs as a consumer weight-loss product.

Enthusiasm for Wegovy among Danes suggests strong potential demand in other western developed countries, but also in areas of the Middle East and in China, where obesity rates are high in urban areas. Prices for GLPs are already falling, making them more accessible to a wider market. The potential market for GLPs may therefore still be underestimated by investors, even after the strong share price rises of producers such as Eli Lilly in 2023.[5]

Arguing the case for the prosecution, it is conceivable that current enthusiasm wanes if consumers tire of GLPs' non-negligible side effects. A recent study suggests that two-thirds of GLP users stop taking them within 12 months,[6] while a clinical trial[7] found that people who stopped taking GLPs regained much of the weight they had lost within a year.

More user-friendly GLP products would be highly desirable, and this is one of the objectives of intensifying research into them. However, the same intense research in pursuit of the holy grail of GLPs could also result in a highly competitive market with undifferentiated products. Were this to happen, prices could fall dramatically in the absence of a significant increase in demand.

**CHART 1** DEATHS BY RISK FACTOR 2019




SOURCE: IHME, GLOBAL BURDEN OF DISEASE, 2019. OURWORLDINDATA.ORG
**NOTE:** RISK FACTORS ARE NOT MUTUALLY EXCLUSIVE: PEOPLE MAY BE EXPOSED TO MULTIPLE RISK FACTORS AND THE NUMBER OF DEATHS CAUSED BY EACH FACTOR IS CALCULATED SEPARATELY.

**GLPs: WHO COULD BENEFIT?**

### + Potential material beneficiaries

- GLP-1 manufacturers
- Peptide manufacturers
- Anti-nausea medications
- Bioprocess vendors
- Injector/pen vendors

### + Potential minor beneficiaries

- Beauty/cosmetics
- Vitamins
- Digital health platforms
- Apparel
- Sportswear
- Healthy food

### = No net material impact

- Alcoholic spirits
- Tobacco
- Type 1 diabetic therapies
- Weight management

### – Potential minor impacts

- Beer/Wine
- Coffee
- Food retailers
- Joint replacement surgery

### – Potential material impacts

- Weight loss surgery
- Type 2 diabetic therapies
- Apnoea treatments
- Insulin
- Fast food
- Casual dining
- Snacking

SOURCE: SARASIN & PARTNERS, NOVEMBER 2023

# OBESITY DRUGS: WEIGHING THE POTENTIAL

Alex Hunter, Partner

- Approximately 5 million deaths a year are attributable to obesity[8]
- Big killers, such as high blood pressure (see chart 1), are strongly linked to excessive weight[9]
- Between 1999 and 2020, US obesity prevalence increased from 30.5% to 41.9%[9]
- The estimated annual medical cost of obesity in the US was nearly $173 billion in 2019[9]
- Globally, about 13% of adults are obese and 39% are overweight[10]

## Winners and losers

In response to the markets' knee-jerk reaction to GLPs, we have taken time to assess the likely winners, and also which companies may have been unfairly marked down in the scramble to reduce the perceived risks posed by GLPs. The market reaction has been overdone in some cases, but investors in healthcare will still need to put some thought into which companies they choose to be exposed to during the next few years.

Eli Lilly and Novo Nordisk are likely to dominate the market for GLPs thanks to the quality of their current products and established pipelines of GLP innovations. In pharmaceuticals, drugs that are best-in-class tend to dominate market share, and Eli Lilly currently has the best-in-class GLP therapy. Other clear beneficiaries are companies such as Thermo Fisher* that supply products used to make and deliver GLPs.

But this is a very nascent market in areas outside type 2 diabetes. Other companies are developing GLP-related therapies, including Pfizer, Amgen*, Roche, Boehringer Ingelheim and Sciwind Biosciences, as well as smaller biotech businesses such as Carmot Therapeutics (recently bought by Roche*). Next-tier GLP challengers such as Amgen and Roche could surprise, and there is also potential for more radical GLP innovation to upset the current market leaders' apple cart.

Elsewhere, suppliers of diabetes treatments, including Medtronic*, may have been oversold. For example, GLPs are not a treatment for type 1 diabetes, and many type 2 diabetics may be reluctant to abandon familiar insulin delivery systems and glucose monitors. GLPs can also work in tandem with existing therapies, for example by being co-prescribed with glucose monitors.

Likewise, GLP use may increase the number of people for whom medical procedures such as joint replacements and heart valves are viable options. This would benefit our investments in Smith & Nephew* (joints) and Edwards Life Sciences* (heart valves), both of which were caught in the recent market downdraught.

Looking at the very long term, it should be borne in mind that, while a thinner population can enjoy better health for longer, they will inevitably require other kinds of medical treatment as they age. Fewer cases of diabetes, heart disease and hypertension suggest more demand for cancer and Alzheimer's treatment and care.

'Diabesity' drugs are a major breakthrough that could significantly improve both the quantity and quality of life across the world. This is likely to shift patterns of healthcare and consumption – decreasing demand in some areas and postponing it in others. However, the biggest thematic driver of healthcare demand will not change: the steady but seismic ageing of western demographics.

1 Macrobond, November 2023. Sarasin portfolio holdings mentioned in this article are marked *

2 Published in August 2023

3 Macrobond, December 2023

4 CNN, Ozempic and Wegovy maker 'just scratching the surface' in meeting demand for weight loss drugs, CEO says, 5 September 2023

5 Bloomberg, November 2023

6 Early- and later-stage persistence with antiobesity medications: A retrospective cohort study, published in Obesity, December 2023

7 Weill Cornell Medicine, SURMOUNT-4 study, December 2023

8 Institute for Health Metrics and Evaluation (IHME), Global Burden of Disease, 2019

9 Centers for Disease Control and Prevention, December 2023

10 World Health Organization, 2016

# COP28

## Markets – not governments – are getting behind net zero

NATASHA LANDELL-MILLS
PARTNER, HEAD OF STEWARDSHIP

Let's face it. Despite world leaders putting on a brave face at the latest round of international climate negotiations – the 28th Conference of Parties (COP28) – the headline result fell dangerously short of what is required. It speaks volumes that this was the first COP to acknowledge that decarbonisation would require a transition away from fossil fuels.

The question for investors, and indeed society, is whether another failed COP matters (see chart 1).

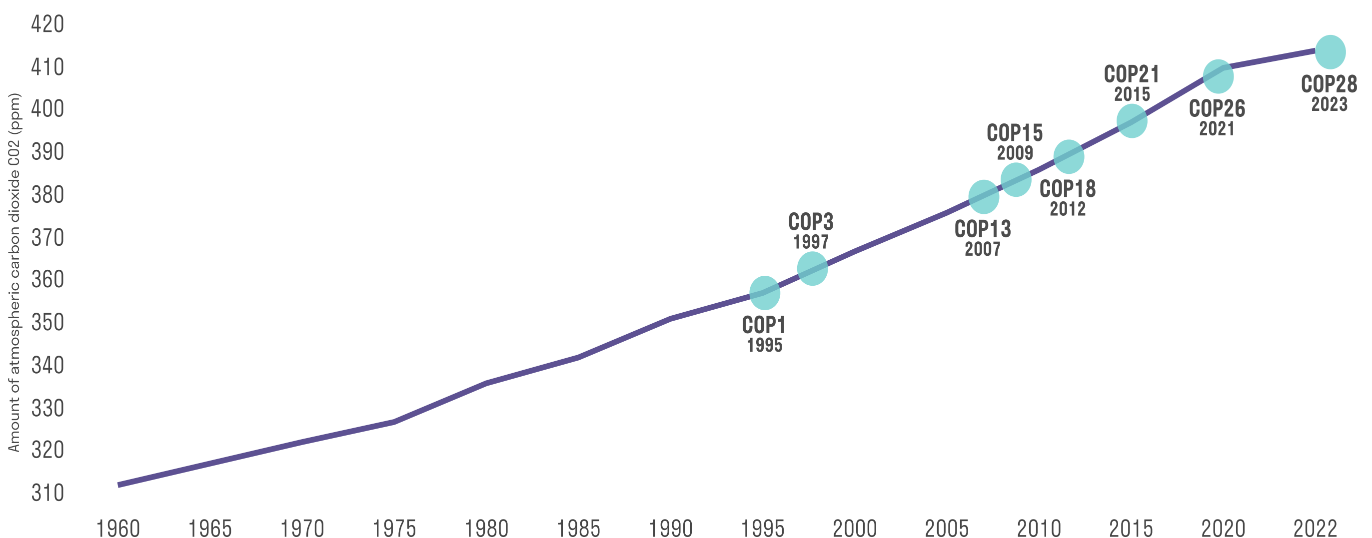
> The most powerful force for change – the market – is backing sustainability. Add concerted government support, and the energy transition could be much easier and faster.

### Clean tech accelerates

Our answer is: yes, it matters. The energy transition will be easier and faster with concerted governmental support. But we mustn't allow the gloom of policy paralysis to blind us to the accelerating clean tech revolution.

In the International Energy Agency's (IEA) June 2023 Renewable Energy Market Update, the evidence of transition is clear.[1] Global additions of renewable power capacity are expected to jump by a third in 2023, the largest absolute increase ever, to more than 440 gigawatts. Solar is the stand-out performer, with manufacturing capacity on track to meet the level of demand envisaged in the IEA's Net Zero Emissions by 2050 scenario.

**CHART 1** THE MAUNA LOA $CO_2$ RECORD, PARTS PER MILLION




SOURCE: GLOBAL WARMING POLICY FOUNDATION, 2022

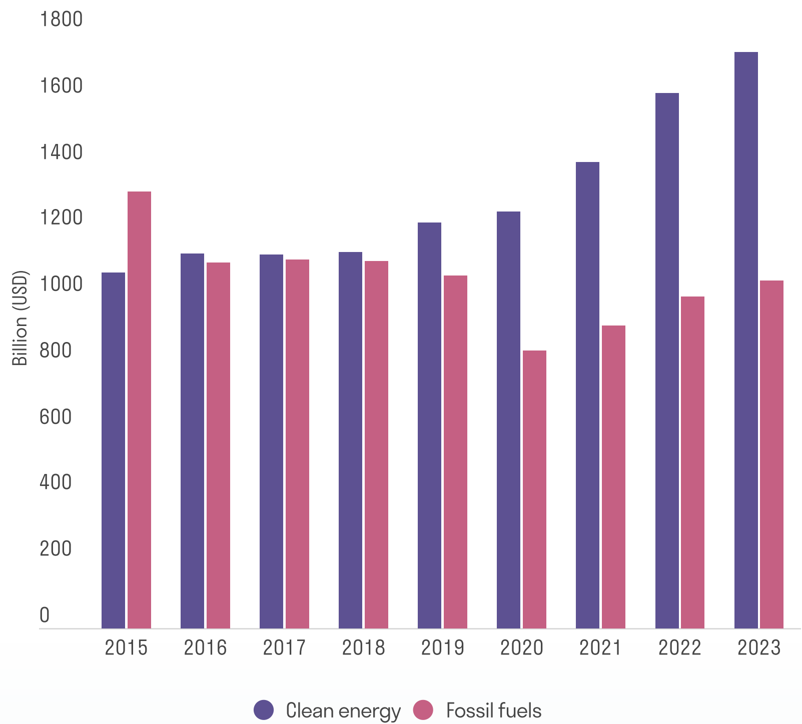
Rather than slowing down the transition, the Ukraine-Russia conflict has led to acceleration. The forecast for renewable capacity additions in Europe has been revised upwards by 40%.

## Cheaper than fossil fuels

Critically, far from imposing costs on consumers, the IEA estimates that wholesale electricity prices in Europe would have been 8% higher in 2022 without the additional renewable capacity.[1] Clean energy will continue to take market share for the simple reasons that it is already – or rapidly becoming – cheaper, more accessible and less vulnerable to geopolitical ructions than fossil fuels.

The attractions of clean energy over fossil fuels is clear from the massive shift in financing, as shown in chart 2.[2] For every $1 spent on fossil fuels today, $1.7 is spent on clean energy. Five years ago, this ratio was 1:1. In the electricity market alone, low-emissions power is expected to account for almost 90% of total investment in generation for 2023.

**CHART 2** GLOBAL ENERGY INVESTMENT IN CLEAN ENERGY AND IN FOSSIL FUELS 2015-2023 (USD BILLION)




SOURCE: WORLD ENERGY INVESTMENT 2023, IEA, MAY 2023

## Can the market keep us within 1.5°C?

The market forces behind clean tech are powerful, but are they enough to keep temperature increases to a 1.5°C limit? While we can't know for sure, the IEA's scenario analysis points to a shortfall. The Stated Policies scenario (STEPS) shows where the IEA expects us to be by 2030 given current policies. Even under the Announced Pledges Scenario (APS), which includes commitments for new policies, we are falling short of what is needed in a 1.5°C scenario targeting net zero emissions by 2030.

While the economics are powerful, the mountain we have to climb to get to net zero is gargantuan. We need everyone, including governments, pulling in the same direction. Above all, governments need to stop obstructing progress. By continuing to subsidise harmful fossil fuel consumption, failing to reform permitting rules for energy and underinvestment in infrastructure for a new age of green technologies, governments add to the obstacles to transition.

So, the COP process does matter and is failing to deliver. However, if we look more closely there is a perceptible silver lining from the latest negotiations. Given the meeting was hosted by a petrostate, it is arguably remarkable that any progress was made. The COP28 President, Sultan Al Jaber (also chair of Abu Dhabi National Oil Company), stood firm behind the need to "keep the 1.5°C North Star alive".

## More steps forward than back

The IEA estimates that the new commitments on methane leakage in oil and gas production, increasing renewables, carbon capture and storage, as well as energy efficiency, will deliver 30% of what is needed for a 1.5°C outcome. While not a major leap forward, it was not a reversal either.

Change rarely happens in a linear fashion. The clean tech revolution, which is already demonstrating its ability to surprise repeatedly on the upside, is no different.

Those with vested interests in the fossil fuel economy will inevitably resist. But in this transition, it is increasingly clear that the most powerful force for change – the market – is moving behind a sustainable planet. This is not just a human imperative; it is also increasingly an economic reality that our clients can benefit from.

[1] Renewable energy market update, IEA, June 2023

[2] World Energy Investment 2023, IEA, May 2023

Charity Focus

# EIGHT STRATEGIC TENETS FOR INVESTMENT SUCCESS IN 2024 AND BEYOND

RICHARD MAITLAND
SENIOR PARTNER, CHARITIES

**Each generation of bright young things believes they will manage things better than their predecessors. Many realise only too late how little they knew for most of their careers The wisest get the balance right between trusting their education and driving innovation, with an acceptance that the future tends to rhyme with the past. Things might look different this time, but they generally aren't!**

The investment industry is no different. New investment techniques and tools have emerged: trades happen in the blink of an eye, news zips around the globe and algorithms are ever-subtler and more complex. However, the best results are achieved by those willing to combine the best of the old and the new.

This is because investment markets are an almost perfect mechanism for embarrassing the most confident and luring the unwary into the same mistakes as the previous generation. The past is littered with Nobel Laureates, PhDs and high-earners who failed to heed sage advice and learnt the error of their ways through experiencing defeat first hand.

At Sarasin & Partners, we constantly welcome new talent into our firm. Over the past 24 months we have hired people with different skills and experience from Abrdn, Barings, Fidelity, RBC, Vanguard and Brewin Dolphin, together with graduates from the universities of Edinburgh, Cardiff and Bristol. We constantly seek to bring in fresh ideas, while helping existing employees to develop their professional knowledge. We also travel extensively to develop our thinking by visiting companies, central bankers, policymakers and other investors.

There are, however, a few cornerstones of successful long-term investment that we suspect will outlast us all. These are tenets that each new generation of investors discovers or re-learns through lived experience – often after seeking heroic results through skill and market timing.

> Investment fashions come and go, but the founding principles of successful investment will outlast us all.

# EIGHT STRATEGIC TENETS FOR INVESTMENT SUCCESS IN 2024 AND BEYOND

Richard Maitland, Senior Partner, Charities

1

## Don't bail out at the bottom

The greatest protection for long-term investors is to acknowledge at the very outset that markets will be volatile. Bubbles and busts will surprise most investors when they happen, in terms of their triggers, timing and size. But while paper losses and opportunity costs might provide investors with an emotional roller coaster, permanent damage is only done if losses are crystallised. Cash that may be required over the short to medium term should not be invested in volatile or illiquid assets, and investment success should not be predicated on clever market timing.

2

## Be optimistic

Policymakers and investors typically find a way to 'muddle through', and many of the things we worry about often don't materialise. Even bull markets climb a wall of worry. If you can spare cash for long-term investment, real assets such as equities will be your friend, even if they make the journey a little uncomfortable from time to time!

3

## Don't switch horses in the middle of the race

This is true whether we are talking about asset classes, investment approaches or investment managers. Many approaches take 5-7 years to prove themselves and even the most successful will disappoint for significant (18-36 months) periods. Markets can follow 'short-term' trends and deviate away from fundamentals for surprisingly long periods. It is always uncomfortable if one's approach falls foul of market fashions.

It is never helpful if a partnership starts off – or ends – with weak performance. The first can pollute a relationship from the start, while the second may spoil things just as a five-year review commences. However, the desire to always be in the top quartile can encourage reckless behaviour. The worst thing a manager can do is to change tack after a period of underperformance, only for their approach to come back into favour. Likewise, asset owners can come unstuck if they switch from an underperforming manager to a star performer just before the latter enters a period of decline.

4

## Don't lose faith in your abilities

During rough patches it is sensible to review processes, procedures and the reasons behind performance, and to do so with a critical and objective eye. To use a sporting analogy, class is permanent but form is temporary. It is the long-run career averages that matter, not a few poor seasons in an otherwise successful long-term career.

5

## Appropriate diversification

A truly long-term investor could put all their assets in a leveraged portfolio of equities and stand a good chance of outperforming most investors over a 30-year period. Most of us, however, will need to draw on our investments – perhaps unexpectedly – long before three decades are up.

Moreover, trustees and objectives change, and even seasoned investors often lack the nerves for full-bore equity volatility or private market illiquidity. Even if some individuals do, their tenure on an investment committee is unlikely to exceed 10 years and their successors might not thank them for their legacy! Diversification between and within assets classes makes sense, even if only at the margins. A slightly lower long-term total return is, we would suggest, a price worth paying for flexibility and a smoother passage through markets.

## 6 Steady evolution, not rare revolution

New asset classes appear from time to time, as do new techniques, new methods of implementation and changes in perception of one's domestic market. Each new idea will have appeared strange, possibly dangerous and quite probably unnecessary when it was first considered. The timing of a new idea rarely feels perfect and there never seems quite enough time for as much education as people desire. However, procrastination is rarely the precursor to success. We suggest that regular small steps result in a portfolio that evolves progressively from decade to decade. Not every step will be correct or perfectly timed, but a good manager or strategist can add significant value if allowed to nudge things along in an incremental manner.

Many approaches take 5-7 years to prove themselves and even the most successful will disappoint for significant periods.

## 7 Manage the things you can control: costs, service, your time

Future performance is unpredictable and known only after the event. However, costs can be calculated and lower costs will add absolute value. Meanwhile, strong service, well-organised meetings and clear materials can make the journey more comfortable. Ensure you pay a fair price and take service-oriented references from clients ahead of any appointment.

## 8 Distinguish between luck and judgement

The best investors and asset owners freely acknowledge the sheer number of factors that influence their decisions. In some cases, brains, hard work and deep analysis can conquer complexity, but not the known, and unknown, unknowns of investment markets. And that is before you get to irrationality, herd mentality, market momentum and pure bad luck!

Long-term success and decision-making will be enhanced if you can judge past performance accurately, but also wisely. Many investment decisions are driven by human nature and are not easily quantifiable. It is rare to have all the facts to hand before making a decision and by the time you do, the opportunity to profit has often passed. Mistakes will be made; the trick is understanding what could have been done better and how to do better next time. Sometimes, the answer will be nothing.

## In conclusion

It is always right to strive for improvement, and for each generation of managers and asset owners to try and do things better and more efficiently than their predecessors. However, if 120 years of investment data and stories of investment hubris can teach us anything, it is that trying to add value through clever active tactics, must be underpinned by robust parameters that you always operate within.

The eight tenets above provide assets owners and managers alike with firm strategic foundations, on top of which can be added tactics to differentiate and excel. We would caution on any policy in which success was entirely predicated on being unusually clever, fast or bold. Investment is a long race that is typically won by the tortoise, even if every time the starting gun is fired, the latest and fastest hares often attract significant backing!

**ALEX BARR**
CO-HEAD,
SARASIN BREAD STREET

**JAMES WITTER**
CO-HEAD,
SARASIN BREAD STREET

# WHERE TO FOR PRIVATE MARKETS IN 2024?

We sat down with Alex Barr and James Witter, co-heads of Sarasin Bread Street, to understand where they see opportunity in private equity.

## It's been an eventful year with many negative headlines about the dynamics of the private equity market – is the asset class still attractive?

The uncertainty caused by steep interest rate rises kept many private equity (PE) investors on the sidelines in 2023, making it a particularly tough time for fundraising. Nonetheless, as PE firms are adjusting to the new environment, we believe the longer-term trends driving PE returns are still intact.

Behind the negative headlines about deal volumes, some of the strongest PE managers have successfully continued significant fundraising efforts during 2023.[1] Agile managers have already sought to take advantage of opportunities that have emerged more recently, for example, there has been a spate of 'take private' transactions of UK-listed companies with depressed valuations. One of these is Apollo's purchase of The Restaurant Group (owner of Wagamama).

It is also important to note that large listings are but one route for managers to exit their investment. In recent years, more than 80% of exits have been via trade sales to strategic buyers or sales to other, typically larger and more global, PE managers.[2] Faced with higher interest rates, successful PE firms are less likely to rely on debt to generate attractive investment returns, and focus on applying industry expertise to improve the companies in their portfolios.

## What are the key investment themes and opportunities in private markets?

Exciting areas for new investment include artificial intelligence (AI) and cyber security, together with a slew of opportunities across automation, digitalisation, healthcare and the transition to lower-carbon economies. These are complex technologies and businesses, so many firms are choosing to specialise in specific sectors and use in-depth knowledge to add value to their investments.

With interest rates appearing to have peaked and markets expecting a series of rate cuts this year, opportunities in the secondary PE market look increasingly attractive. (Primary PE funds invest directly in private companies; in the secondary market, investors can buy a stake in these primary funds, offering a greater degree of liquidity.)

## What do you look for when selecting private equity managers?

It's important that PE managers can identify crucial areas where a business can be improved, and then apply practical expertise to help create value. Sarasin Bread Street's leadership team has been investing with leading PE managers for over 20 years[3] and has a global network of manager relationships.

We believe the most successful private equity managers are able to draw on extensive resources, such as expertise in mergers & acquisitions, pricing, capital markets, procurement and other specialist areas such as innovative use of data and analytics – for example, through good use of AI tools. These capabilities are increasingly important for managers to gain and maintain a competitive edge.

## How can investors start allocating to PE?

Whilst there is no single 'right' way, seasoned investors in the asset class generally build PE exposure gradually, deploying capital over a number of years. In PE, it's essential to select the best managers in order to access the type of returns that private markets have generally delivered.[4]

Investors can build private equity exposure through a disciplined approach to annual investment and reinvestment, in a manner designed to provide a carefully selected balanced portfolio of private equity investments.

[1] Sarasin & Partners, January 2024

[2] S&P Global Market Intelligence, Global private equity exit total up in Q3 to largest quarterly total in 2023, October 2023

[3] At previous employers, Sarasin & Partners LLP makes no representations or warranties in respect of any historic implied investment performance. Sarasin Bread Street was established in 2022 following Sarasin & Partners' acquisition of the team behind Bread Street Capital Partners.

[4] Bain & Company, Global Private Equity Report 2023

# EVENTS

Q1 2024

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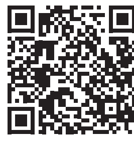
Visit our website, sarasinandpartners.com for more information

## Spring Seminars 2024

We look forward to welcoming you to our annual Spring Seminars, where you can hear from our Charity Investment, Asset Management and Private Client teams. The seminars are held in person in London and registrations are now open on our website.

14:00 – 18:00 including drinks and canapés



Scan for more information

10:00 – 14:00, including lunch

## Charity Forum Lunches

We host a monthly Charity Forum Lunch at our offices; if you would like to receive further information or to attend, please email charityevents@sarasin.co.uk.

## Trustee Investment Training in conjunction with Charity Finance Group

This training is free of charge and further details can be found on our website:

### Foundation trustee training

Virtual sessions

**6 February | 18 June**

**09:30 – 11:30**

In-person sessions

**23 April | 1 October**

**14:00 – 17:00**

Scan for more information

### Advanced trustee training

Virtual sessions

**5 March | 12 Nov**

**09:30 – 11:30**

In-person sessions

**21 May | 10 Sept**

**14:00 – 17:00**

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